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Economic Conditions Governmental Finance United States Securities

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General Business Conditions

THE reports of industrial production have come in for more than the usual examination and discussion during the past few weeks. Due to the concern which government officials have shown over the slower rate of gain in war output, and to a check in the rise of general industrial activity, the impression exists in some quarters that a "slump" or "slackening" has appeared. Both these terms, however, convey an erroneous idea. Apart from some individual plants, where special conditions may cause production to fall off at times, the only significant slump has been that in coal mining, and in a few steel mills, during the strike of the United Mine Workers. This strike depressed the Federal Reserve Board's index of industrial production in June to 202 (1935-39 = 100). This was the same figure as last February, marking four months of sideways movement; but the index rose again in July to 205, a new high record, and preliminary evidence suggests that it will be still higher for August.

The trend of war production is upward. The War Production Board's index of munitions output in May was unchanged from April. In June, however, it rose 2 per cent and in July another 3 per cent. According to this index munitions production is six times the rate which prevailed just before Pearl Harbor. The concern that has been expressed arises from the fact that the rate of increase has tapered off, and that output is below schedules. Some of the earlier projections have had to be revised downward.

From these figures it can be argued equally that production is good because it is so tremendous, or poor because it is not rising faster and has not reached levels hoped for at this time. The real test is whether the armed forces get all they can use. This country alone is turning out far more than all the Axis nations together. The automobile industry is producing more than twice the amount of goods for war that it ever did for its peacetime trade, and production of the aviation industry (in

which most of the automobile companies of course participate) is four or five times as large as that of the pre-war automobile industry. In some munitions and supply items, requirements are so well covered that production has been cut back; and for the offensives thus far undertaken all the material that could be effectively used appears to have been available.

On the other hand, production of many items, notably airplanes, can never be too large; and Army schedules contemplate greater offensives to come. Naturally the public has not been informed of the decisions of the Quebec Conference, but no announcement was needed to show that they must have been in the direction of speeding up the military effort. New and greater offensives as soon as practicable—to take advantage of the great victories in Russia, the Mediterranean and Pacific, to strengthen the bombing assault on Europe and the anti-submarine campaign, to make capital of favorable political developments in Italy, Denmark and Bulgaria, and to give the Axis the least possible rest—would shorten the war. To reach these objectives will require the utmost productive effort of which the country is capable. The improvement in shipping is a challenge to expand production now that the goods can be moved.

Reasons for Slower Production Increase

Concern over production is justified, for new difficulties have to be overcome if munitions output is to be kept moving upward. There are a number of reasons why the rate of increase has slowed down. One is that the program itself has been subject to much change and revision, with contracts cancelled and deliveries deferred because of redesigning, of shifts in requirements, or accumulation of stocks. The intent is to replace cancelled contracts with others, but loss of time and production in making the changeover is inevitable. Strikes, difficulties in management, and other factors also contribute. Surveys of the situation generally agree, however, that the

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major overall restrictive factor is shortage of manpower, complicated by excessive labor turnover and absenteeism.

Shortage of manpower is evidence that the country at last is approaching the ceiling of its productive capacity. In its early stages the need of the war production program was for specialized munitions plants. Later, shortage of materials became the critical difficulty. During this period unemployed labor was largely absorbed, and a great shift of workers took place from farms, from homes, and from civilian occupations depressed by the impact of war, to the war manufacturing centers. These sources, however, are no longer the great reservoirs of labor that they have been.

The War Manpower Commission estimates that 4 million more persons will be required by the armed forces and the war industries by July 1944. It calculates that additions to the labor supply will total 1,400,000 while 2,600,000 will be required to shift from other employment. It expects that the decline in construction will release about 800,000 workers and that trade and service industries will be able to give up 700,000 to war work. But this leaves a gap of more than one million to be covered. Meanwhile many industries are losing old workers almost as rapidly as they find new ones. Selective service takes some away, many have left the factories to go back to the farms, and many women who entered industry have quit under the double load of home responsibilities and running a job.

The difficulties in the way of expanding production are formidable. Naturally the limit of the country's capacity must be reached some time, and as it is approached gains are harder to make, for expansion in one place may cause contraction elsewhere. Nevertheless, it would be unwarrantedly pessimistic to conclude that the overall production ceiling has yet been reached. More steel mills will come into operation as time goes on, for the steel expansion program is only a little more than two-thirds complete. More aluminum and magnesium will be available, more of other materials, and more war plants to fabricate them. To find the labor to produce these materials and make them into finished goods will call for better organization and management, more housing and services in the war centers, reduction of the quit rate and absenteeism, and elimination of strikes. It will also call for a shift of workers into war factories, which may have to cut deeper than heretofore and may require some re-examination of what is essential and non-essential to the war effort.

The War Manpower Commission has expanded the list of occupations deferable under the Selective Service Act and has ordered occupation to be put before dependency as a cause for deferment. These and other moves

attempt to make voluntary manpower mobilization work. Whether the policy will get out all the production needed is something which only time will tell, but public sentiment will support a thorough trial of alternative methods before turning to a labor draft.

Scolding Producers

The occasional statement that complacency and over-optimism are curtailing production is seldom supported by responsible and informed opinion. Probably it is entitled to less consideration than another element in the situation, which is the tendency to scold and denounce armament producers in order to make it appear that they are not living up to their responsibilities. Unfortunately, in isolated cases ground for criticism of management has been found, as in the two or three instances where an employe or under-official, from a desire to set high production records, has cut corners in Army and Navy specifications; or where shop procedures, set up under the great pressure to expand, with experienced management worn thin, have proved inadequate.

Of course, real derelictions should be exposed, conditions corrected, and those responsible punished; but it does not follow that public castigation of whole corporations, which are devoting themselves solely to the war effort and breaking all production records to support it, of industry in general, and even of the private enterprise system, is warranted or helpful. The delinquencies have been insignificantly few; inferior products in nearly every case have been caught in inspection and the armed forces have not suffered; and the situation has been promptly corrected by the management of the companies concerned.

Under these conditions general denunciations weaken the morale of management and workers alike. They cause a natural resentment, disheartenment, and "tightening up", which in certain cases has been a prime cause of a production drop. If such cases are dealt with reasonably and fairly, without attempting to spread blame beyond where it belongs, production will be helped.

Curtailment of Army Purchases

One evidence of sufficiency of production for the armed forces in certain lines is a curtailment of purchases and spreading out of deliveries, which will release more goods for civilian use. This applies principally to textiles, also to canned foods. The War Department has announced that its needs for cotton goods in 1944 will be about 50 per cent under 1943, and that in the last quarter of this year deliveries of three types of cotton fabrics will be reduced by half and the delayed deliveries transferred to the first quarter of next year.

The peak demand for woolens and worsteds is past and deliveries are being lengthened. The Department has stated that initial clothing requirements for troops are nearly completed and thereafter only replacement materials will be needed.

Other indications have pointed toward a moderate improvement in civilian supplies. Allocations of steel for miscellaneous civilian purposes in the fourth quarter have been moderately increased. Allowances of sugar for manufacturing purposes have been substantially raised. On the other hand, the paper situation is tightening, and concern as to the coal supply has caused issuance of regulations to insure the most effective distribution of coal production.

The textile trades are properly cautioning their customers against exaggerated expectations of increased supplies. The uncertain point is the extent to which the reduction of Army purchases may be offset by inability to maintain production rates as the labor supply tightens. In July mill consumption of raw cotton was 16 per cent less than a year earlier, due to difficulty in keeping up the work force. Nevertheless, fears of clothing rationing are no longer generally felt, and it is significant that deliveries of Fall merchandise to retailers against their earlier purchases have been somewhat larger than they looked for.

Orders for Fall goods placed by retailers were extremely heavy, and the outstanding commitments of most stores are far above last year. In the past month a note of caution has appeared in buying policies in a good many quarters. This reflects not only the heavy commitments and the possibility that civilian supply may have been underestimated; it is due also to widespread confidence in a victorious end of the European war within 1944, if not earlier. Retailers are not likely to be caught with excessive inventories in an overall sense at the end of the war, but they may find their stocks unbalanced, with too much of the lower-quality goods produced under war conditions. When the shift back to production for civilian use is clearly seen approaching, housewives may be expected to defer purchases until they can get goods of the accustomed pre-war quality, and this is a change for which merchants will want to be prepared.

In attempting to discount the end of the war, business sentiment is likely to fluctuate considerably. Beginning with the fall of Mussolini and extending through the political developments since, the past month has been a favorable period for the United Nations. On the other hand, there is some disappointment that the Allies were not ready to take advantage of the turn by moving on Italy earlier. Ideas as to the length of the war will be controlled

by developments, which are seldom always in one direction.

Price and Wage Controversies Quieted

The controversies over price and wage regulation, the handling of food problems and similar questions have quieted considerably during the Summer months. New proposals for keeping the cost of living down and satisfying the claims of farmers and factory workers are expected after Congress reconvenes; and together with wage demands now in suspense they may start the pot boiling again. Nevertheless, the conditions which were responsible for much of the confusion and conflict in the stabilization program have been genuinely bettered. The rise in the cost of living has been interrupted; the official index number calculated by the Bureau of Labor Statistics dropped 0.2 per cent in June and 0.8 per cent in July, which is the first decline over a two months' period since the war began. The course of commodity prices generally has been sideways, on a level slightly lower than the peaks reached at the end of the Spring.

The Office of Price Administration is undergoing a reorganization which is putting more experienced business men in positions where business experience was needed, and it will enjoy greater confidence, cooperation and effectiveness by reason of the change. The difficulties of the O.P.A. under any conditions are extreme; they proved insurmountable as long as the policy was to place no trust in business people, who in last analysis have to make the controls work. The lesson that able and patriotic men of experience and prestige will do better than equally patriotic men without those qualifications, and that a business policy will be executed better if business men have a real share of the responsibility, seems to have been learned.

These are all significant developments. The labor unions' arguments for breaking the Little Steel formula and a general markup of wage rates are largely based upon the past advances of the official cost of living index; and although the unions demand not only that living costs be stopped from rising, but that they be rolled back to the level of September 15, 1942, their demands cannot be pressed very forcefully at a time when the trend is actually downward.

At least a breathing spell has been afforded for strengthening the overall stabilization program. The War Labor Board, which had been pessimistic as to its ability to keep the Little Steel formula in effect if living costs kept on rising, has taken a strong position with respect to new wage demands. It has denied increases to shipyard workers and portal-to-portal pay for the Illinois coal miners. In his speech August 16, Mr. Byrnes put great stress on the halt to the rise in prices, and on the fact that

the "take home" pay of factory workers had increased much more than living costs, counting from Pearl Harbor.

Credit for the greater price stability belongs not only to the controls, but to seasonal increases in food supplies; to the influence of the collectively huge production of Victory gardens; to larger supplies of imported goods since the shipping situation eased; and not least of all to a very considerable restraint in buying among the people of the country. With income payments to individuals, less taxes, running some 15 per cent above a year ago, and the "inflation gap" (amount available for spending or saving, over and above production of civilian goods) estimated by the Department of Commerce at \$37 billions this year, department and chain store sales recently have averaged 5 to 10 per cent above last year, while mail order houses show little or no gain. This is a heavy volume of business, and represents a fairly free satisfaction of consumer wants, but it is considerably short of the panicky competitive buying and bidding up of prices which many students of the inflation prospect have feared.

Whether it is enforced by controls and rationing, or is voluntary, people should have credit for their prudence and restraint, which take the form of saving and paying off debts, undoubtedly for patriotic reasons as well as for future well-being and security. Their disposition in this respect is a hopeful indication of great success and a large oversubscription for the Third War Loan.

The September Bond Drive

On September 9 the United States Treasury will embark upon the largest single financial undertaking in history—the raising of a \$15 billion loan from the people of the country.

In planning this huge operation, the Treasury has made plain its two-fold objective—(1) to raise money needed for carrying on the war, and (2) to raise the money in a way that will not be inflationary.

Of these two objectives, only the latter presents any real problem. There never has been any question that whatever sum total of dollars is needed will be provided. The important thing is to raise these dollars in the right places, so that their expenditure by the Treasury will not release such a flood of purchasing power as to burst the barriers of price controls and let loose the dreaded spiral of inflation.

This means, first, getting as much money as possible from the current income of the people that would otherwise be spent. Individuals must save more, and make their savings available to the Government through the purchase of war bonds. Dollars raised in this way are anti-inflationary dollars, since they come from individuals cutting down their spending and

thus reducing civilian demands upon production at a time when the demands of the war effort are increasing.

It means, second, reaching the already existing pools of savings constantly accumulating in the insurance companies, savings banks, pension funds, trusts, by sales to these institutions and funds, as well as drawing in the temporarily idle funds of individuals and corporations. Some of the currency now hoarded should be put into bonds. Such dollars, while not as anti-inflationary as dollars raised from an increased rate of individual savings, are nevertheless non-inflationary in the sense of not adding to the total spending power but of merely transferring it to the Government.

It means, third, keeping the volume of funds raised from the commercial banks to a minimum. For dollars obtained by selling government securities to the commercial banks are highly inflationary dollars, since they represent an expansion of credit and hence add to the total of purchasing power available.

It is in recognition of these principles that the Treasury is centering the new bond drive exclusively on non-commercial banking lenders. Of the \$15 billion objective, the aim is to raise \$10 billions from the corporations, insurance companies, and other non-commercial banking institutions, and \$5 billions from individuals. To attain these goals will require not only the full support of the corporate and institutional investors, but more especially a tremendous effort to expand the sales to individuals who altogether are receiving the largest national income ever paid out. It means, particularly, getting in the "little fellow" who is the hardest to reach with any complete coverage, because of his great numbers and because he is likely to feel that when the sums wanted are so large his own possible contribution becomes unimportant. Yet it is the "little fellows" who make up the vast majority of our citizenry and whose incomes in the aggregate represent the great bulk of the income of the nation as a whole.

The Treasury and the State War Finance Committees have mapped their plans on this basis. Their aim is the widest possible educational campaign, with greatly stepped up programs of publicity in the press, over the air, in the theatres, and in many forms of community activities. In addition to the more extensive use of the usual channels of publicity, there is being recruited a nationwide army of volunteer workers who, under direction of the State War Finance Committees, will endeavor to contact every person in the nation individually.

As in the first two war loans, the securities to be offered will include a variety of issues to appeal to the requirements of every type of buyer, from the largest corporate and institutional investor down to the individual purchaser

of a \$25 war savings bond. They will include, in addition to the Series E, F, and G savings bonds and tax savings notes, $\frac{1}{8}$ per cent certificates of indebtedness, 2 per cent 8-10 year bonds, and $2\frac{1}{2}$ per cent 21-26 year bonds.

A Pledge of Patriotism

The great bond selling campaign for the Third War Loan which begins on September 9 is much more than a sale of bonds to raise money for the Treasury. It is the occasion for a renewed pledge by all the people of their loyalty to the country. It will be a demonstration of our unity in essentials. It will be a reassurance of economic stability.

In a Congressional hearing not long after World War I the Assistant Secretary of the Treasury who guided the financing of that war, Mr. Russell C. Leffingwell, had this to say

No one in America was ever allowed to forget that there was a war, that he had a part in it, that that part included buying Liberty bonds or Victory notes, and that to do so he must save money. In the history of finance no device was ever evolved so effective for procuring saving as the Liberty loan campaigns. Everyone was always buying a Liberty bond or Victory note, or trying to pay for one, or getting ready to buy bonds or notes of the next issue. The loan campaigns stand out in my mind as the most magnificent economic achievement of any people.

Everyone of the volunteer salesmen who go forth to sell bonds on September 9 will be selling more than bonds. He will be selling:

1. **National unity and enthusiasm** in the war effort. Production has reached a crucial stage in the upward curve where our resources of man-power are being put to the test. A new outpouring of national energies, a new dedication to our objectives, is required to keep production moving ahead. It must be overwhelming, if the enemy is to be overwhelmed. Production can be helped by this campaign. When bond purchases in a war plant rise production goes up too.

2. **The best safeguard against inflation.** This campaign is the best way to encourage saving, and saving—instead of spending—is what we must all do to avoid inflation. Otherwise the huge government spending, plus private spending, must inevitably drive prices up. Saving instead of spending frees labor and materials for war production.

3. **Security and stability** for each of us and for our country. To the extent we save now we have security later. If all the people save at this time when the national income is swollen from war spending we shall avoid a still greater boom and a great collapse. We shall have money to spend later when there may be danger of depression. Spending then will foster stability. Moreover, people who are shareholders and partners in the nation are better citizens.

These sales are supremely worth making. The War Loan is our great opportunity at

home to back the boys who are out doing the fighting. They do their job magnificently. We must do ours.

Money and Banking

Interest in the money market during the past month has centered largely in plans and preparations for the new bond drive. The government bond market has been generally quiet and steady except for some selling of 2 per cent issues around the middle of the month by savings banks readjusting their portfolios in anticipation of the Third War Loan. Some insurance company selling of municipals and considerable shifting in state and municipal sinking fund accounts in preparation for the new federal issues took place during the month, though on the whole the amount of anticipatory portfolio readjustment by investors has appeared to be a good deal smaller than before either of the two earlier drives.

The country enters upon the new borrowing operation with member bank excess reserves hovering just over the \$1 billion mark, or around the lowest since 1937. For some six months past excess reserves in the principal money centers of New York and Chicago have stood at negligible totals, and generally throughout the country excess reserves have been declining, due to steadily rising currency demands, expanding deposit liabilities, and an increasing tendency on the part of banks to invest their reserves more fully.

Nevertheless, despite the current relatively low total of excess reserves, the money market will be readily able to handle the new government financing. It may be remembered that as commercial banks are excluded from the drive this is not a credit expanding operation, but involves merely a shifting of funds from individuals, institutions, and other subscribers to the credit of the Government. Actually, in this process, excess reserves should be temporarily increased. For as subscribers pay for their bonds and the proceeds are credited to war loan deposits (not requiring reserve) in the commercial banks, reserve requirements will be reduced and excess reserves correspondingly increased. Later, of course, as the Treasury calls in these deposits and redisburses them to individuals and corporations in meeting Treasury expenditures, reserve requirements will again rise and excess reserves be reduced.

The Reserve Banks and the Money Market

Over the longer-term, prospects point to further rapidly mounting demands upon the banking system. Currency requirements are rising at the rate of over \$5 billions a year, and give no sign as yet of tapering off. Along with the currency increase, deposit liabilities are expanding and taking more reserve, and are bound to expand more as banks are called

upon to finance their share of the federal deficit.

All this means an increasing dependence of the member banks upon the Federal Reserve Banks. The latter have indicated that they stand ready to meet this demand and to supply funds needed to maintain an orderly market and support Treasury financing. Over the past year they have added more than \$6.5 billions to money market funds by the purchase of some \$5.3 billions of government securities and by reducing reserve requirements in central reserve cities from 26 to 20 per cent.

During recent months, Reserve Bank aid to the market has taken the form chiefly of purchases of Treasury bills. As member banks have run short of reserve from time to time they have sold bills to the Reserve Banks instead of disposing of longer-term securities yielding more remunerative interest rates. At the same time banks having excess reserves have shown a distinct preference in their purchases for the higher yielding maturities. The result has been that the bill holdings of the "Federal" have gone higher and higher, while bond holdings have been substantially reduced as the Reserve Banks have sold these issues to help meet the demand and keep prices from rising too rapidly.

Since the end of 1942 Federal Reserve holdings of bills have expanded by approximately \$4.6 billions, while holdings of bonds have declined \$1.3 billion. On August 25 the Reserve Banks held more than 60 per cent of their government portfolio in bills, and such holdings amounted to more than 40 per cent of the total Treasury bills outstanding.

With the Treasury committed to the policy of maintaining the prevailing spread between short-term and long-term interest rates, the increasing saturation of the bill market has made desirable an easing up in the program of new bill offerings. Accordingly, the Treasury, which had been steadily increasing these issues so as to get \$200 millions of new money weekly through the excess of offerings over maturities, stabilized the weekly sale at \$1 billion in July. Since that time the excess of offerings has been but \$100 millions weekly, and beginning September 16th new offerings, assuming that the present rate is retained, will only cover the maturities, raising no new money. Since spring of 1942, the stepping up of the weekly bill issue has brought about an increase in the total amount outstanding from around \$2 billions to almost \$13 billions.

Wartime Industrial Expansion and Post-War Reserves

The continuing renegotiation of government contracts so as to recapture the earnings resulting from lowered costs, improved methods,

and mass production is proving to be an extremely difficult process, even with the close cooperation that has prevailed almost universally between industry and the various government price adjustment boards. On countless items, industry has cut the cost of production far below the original estimates, and this is reducing substantially the total of war expenditures and the future burden upon tax-payers. Uncertainty of business over terms of contract renegotiation and termination, however, has become a serious addition to the many other hazards inherent in the war-time production of war materials.

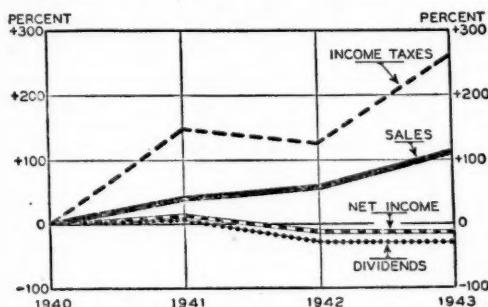
Renegotiation has cut approximately \$3,956 millions from the payments due war contractors in cases settled by the price adjustment boards up to the end of July, of which \$1,788 millions represented commitments for cash refunds and \$2,168 millions price reductions on future deliveries under existing contracts. The recent joint statement by the Army, Navy, Maritime Commission and Treasury Department emphasized that the figure of \$3,956 millions does not include those savings resulting from lower prices in succeeding contracts, "not susceptible of accurate measurements or even an approximate estimation but savings undoubtedly many times greater than the measurable recoveries and price deductions in existing contracts". Since about four-fifths of the "savings" through renegotiation is offset by the high income taxes, however, only one-fifth represents net gain to the Treasury.

In addition to the difficult administrative problems in connection with renegotiation, many broad questions involving public policy have become increasingly pressing and can be dealt with adequately only by action of Congress. The House Ways and Means Committee considers the subject of such importance that it has decided to postpone hearings on the 1943 revenue bill until after hearings on renegotiation of contracts, scheduled to start September 9, have been concluded.

One of the suggested changes in the renegotiation law to receive special attention is that reasonable "reserves" which many war contractors have been setting aside to provide for reconversion and post-war contingencies should be permitted, under prescribed conditions, as allowable deductions in computing net income for both contract and income tax purposes. Another is that earnings of war contractors be considered after taxes rather than before, because of the high but widely varying "effective rate" of tax on different companies making the same product. A third is that contracts be exempted from renegotiation if the percentage of net earnings (after taxes) to sales is below a specified minimum.

Expansion of War Material Manufacturers

The concern of war contractors over earnings and reserves is due to derangement of their peacetime organizations and to the tremendous expansion made in their volume of business in order to meet the demands of war production; and also to the experience after the last war and through the depression years of the 1930s, when it was only the surpluses accumulated in good years that enabled business to keep going. The accompanying chart and table show the expansion in sales, assets and liabilities since 1940 of a group of 80 large war material manufacturers whose June 30, 1943 balance sheets are now available.



Percentage Changes Since 1940 in Sales, Income Taxes, Net Income and Dividends of 80 Large Manufacturers of War Materials. (Figures for 1943 Based on Rate of First Six Months.)

Sales of this group for the first half year 1943 were at an annual rate of approximately \$11.7 billions, which was about 111 per cent larger than in 1940, and are still rising. This reflects the accomplishments of American industry in rapidly converting its organization, plants and equipment to the production of war goods, and now turning out such quantities of airplanes, tanks, ships, guns, shells, ammunition and other vital materials as must literally overwhelm the Axis countries, which had spent long years in the preparation for war.

Income taxes in the first half of 1943 were at a rate 260 per cent higher than in 1940, but net income after tax and other reserves was 11 per cent lower than in 1940. Corporate income taxes absorbed about 70 per cent of net income in 1943, in contrast with 37 per cent in 1940. Dividend payments were at a rate 29 per cent lower than in 1940, and net dividend yield to shareholders was cut further by the sharp increases in personal income tax rates.

Accompanying the great expansion in volume of sales, the margin of net income (after taxes) to sales shows an even sharper drop than dollar net income, declining from 9.1 per cent in the peacetime year 1940 to 7.3 per cent in 1941, 5.1 per cent in 1942 and 3.8 per cent in the first half of 1943.

These figures taken from published statements differ from the earnings data compiled in the Treasury Department annual "Statistics of Income" and recently summarized by the Department of Commerce ("Survey of Current Business", June 1943) in that the government tables are based upon the statutory definition of net income for tax purposes and show earnings before charges for the various general, contingency or post-war reserves, which are not allowable deductions for tax purposes. The Department of Commerce study pointed out that had contingency provisions been allowed as deductions, the profits estimates for the last two years would have been lower. This technical but important distinction is not always noted when comparisons are made of corporate earnings.

It is true that many companies have had a marked improvement in earnings as a result of the war, but examples sometimes cited where the gains amount to "several hundred per cent"

80 Manufacturers of War Materials with Annual Sales Over \$5 Millions

(In Millions of Dollars)

	Year 1940	Year 1941	Year 1942	Year 1943	6 Mos. 1943
Income Account					
Sales	\$5,545	\$7,794	\$8,772	\$5,847	
Net income before taxes	798	1,303	1,112	754	
Income & exc. prof. taxes	295	732	667	531	
Net income after taxes	503	571	445	223	
Dividends paid	358	418	278	138	
Retained net income.....	115	153	167	85	
Assets					
Cash	895	677	881	1,173	
U. S. Govt. securities*....	185	581	506	571	
Receivables, net	548	759	1,242	1,254	
Inventories	1,095	1,443	1,714	1,714	
Total current assets...	2,723	3,460	4,343	4,712	
Plant and equipment....	3,630	3,795	3,850	3,847	
Less depreciation	1,761	1,872	2,003	2,104	
Net property	1,869	1,923	1,847	1,743	
Other assets	820	851	903	799	
Total assets	5,412	6,234	7,093	7,254	
Liabilities & Capital					
Notes payable	49	69	165	53	
Accts. pay. & accruals..	638	724	1,220	1,139	
Reserve for taxes	337	811	793	998	
Total current liab.	1,024	1,604	2,178	2,190	
Deferred liabilities	266	290	320	283	
Reserves	220	288	333	419	
Capital and surplus	3,902	4,052	4,262	4,362	
Total	5,412	6,234	7,093	7,254	
Working capital	1,699	1,856	2,165	2,522	
Current ratio	2.66	2.16	1.99	2.15	

*Includes tax notes of \$513 millions in 1941, \$418 millions in 1942 and \$469 millions in 1943.

This table is based upon companies engaged wholly or to a large extent upon war work in the following industries: Cotton goods 2, woolens 2, rayon 1, miscellaneous textile products 5, clothing 3, rubber products 4, wood products 4, paper products 3, chemicals, paints and explosives 11, stone, clay and glass 2, iron and steel 3, building equipment 2, electrical equipment 3, hardware and tools 4, household equipment 1, machinery 6, office equipment 1, nonferrous metals 2, miscellaneous metal products 3, automobiles 6, auto equipment 4, railway equipment 8, aircraft and parts 2, and miscellaneous manufacturing 8.

The corporate sales figures include products made in war plants financed or leased by the Government, but are exclusive of the production of plants owned by the Government and operated by these companies under contract.

are usually confined to small companies, or those which previously had been operating on the borderline of profits or in the "red", so that large percentage changes may be misleading. Such cases are now being taken care of through excess profits taxes and renegotiation of contracts, and are not considered typical of the war industries generally.

Changes in Composite Balance Sheet

The balance sheet comparison up to June 30, 1943 shows a heavy expansion in holdings of cash, government securities, receivables and inventory, accompanied by a somewhat smaller but nevertheless heavy expansion of current liabilities, including reserves for taxes. Net current assets or "working capital" have risen steadily, and while the "current ratio" is below that of 1940, it would be almost as high if holdings of U. S. tax notes were offset against tax liabilities. It is recognized generally that industry should make every effort to maintain a strong and liquid condition, not only to finish its share in the job of winning the war, but to finance post-war conversion and furnish employment in the production of peacetime goods.

Because of wartime expansion, however, the real test of liquidity is not merely the "current ratio" but the value and liquidity of swollen receivables and inventory. These in turn depend upon the fairness and promptness with which settlements are made by the Government and by other contractors on the receivables and inventory, which are based to a large extent on finished war products, goods in process and raw materials having little peacetime value.

Moreover, the composite statement given is merely illustrative, since the sample group is limited by the number of companies which publish complete semi-annual statements, representing only about 9 per cent of the assets of all manufacturing corporations in the United States, and because the composite does not reveal the much more extended position of many individual companies. For example, while the group statement shows that sales in 1940 were about $3\frac{1}{4}$ times working capital, and in 1943 had risen to a rate of $4\frac{1}{2}$ times working capital, the aircraft industry has expanded to the point where, even for the full year 1942, combined sales of the twenty largest producers were 16 times their working capital.

There is another need in addition to that for prompt and fair settlement of contracts with the many companies which have expanded several-fold their volume of production and/or have virtually scrapped their peacetime facilities. That need is for net earnings, after taxes, sufficient to enable the companies to set aside something with which to rebuild their organizations after the war. Because of excess profits tax rates running up to 90 per cent, however,

the building up of surplus has not been possible to any large extent, particularly for those companies which have greatly expanded on a small "invested capital base" for excess profits tax credit, and thus need surplus the most.

Over a long period of time, the growth of American business has been financed to substantial extent by retaining a portion of its own income, after payment of taxes and dividends, for investment in new plant and equipment. A great deal of industrial capital is required, year in and year out, to expand in the development of new products and new processes, to provide for normal growth and to replace the continual losses resulting from economic changes. This equity or "risk" capital has come jointly from the savings and investment of individuals, and from earnings ploughed back into business. For the corporate system as a whole, a summary of net income after taxes, dividends paid and retained net income for the period 1909-1941 is given in the accompanying table.

It will be seen that in the 33-year period there were 10 years of net deficits, or of dividend payments in excess of net income, and consequently no net business savings by all corporations taken as a group. Figures for the

Net Dividend Payments and Retained Net Income of All Active Corporations in the U. S.

	Net Income after Taxes(a)	Net Dividend Payts.(a) Amount	% of Net Inc.	Retained Net Income Amount	% of Net Inc.
1909	\$2,599	\$1,567	60.3	\$1,032	39.7
1910	2,906	1,828	62.9	1,078	37.1
1911	2,531	1,866	73.7	665	26.3
1912	3,425	1,950	56.9	1,475	43.1
1913	3,847	2,167	64.7	1,180	35.3
1914	2,371	2,028	85.5	843	14.5
1915	4,088	2,055	50.3	2,028	49.7
1916	7,408	2,500	33.7	4,908	66.3
1917	7,342	3,025	41.2	4,317	58.8
1918	4,553	2,620	57.5	1,933	42.5
1919	6,307	2,600	41.2	3,707	58.8
1920	4,843	2,900	66.8	1,443	33.2
1921	24	2,630	(b)	d-2,606	(c)
1922	4,380	2,634	60.1	1,746	39.9
1923	5,827	3,299	56.6	2,528	43.4
1924	4,998	3,424	68.5	1,574	31.5
1925	6,971	4,014	57.6	2,957	42.4
1926	6,774	4,439	65.5	2,335	34.5
1927	5,880	4,765	81.0	1,115	19.0
1928	7,566	5,166	68.3	2,400	31.7
1929	8,084	5,927	73.3	2,157	26.7
1930	1,366	5,613	(b)	d-4,247	(c)
1931	d-3,145	4,182	(c)	d-7,827	(c)
1932	d-5,375	2,626	(c)	d-8,001	(c)
1933	d-2,379	2,101	(c)	d-4,480	(c)
1934	157	2,642	(b)	d-2,485	(c)
1935	1,674	2,927	(b)	d-1,253	(c)
1936	3,908	4,702	(b)	d- 799	(c)
1937	3,872	4,832	(b)	d- 960	(c)
1938	1,480	3,222	(b)	d-1,742	(c)
1939	4,040	3,841	95.1	199	4.9
1940	4,778	4,067	85.1	711	14.9
1941-p	7,209	4,464	61.9	2,745	38.1

Sources: 1909-1937 from Temporary National Economic Committee, Monograph No. 12, entitled "Profits, Productive Activities and New Investment", Table VI, based largely upon Treasury Department "Statistics of Income"; 1938-1941 from "Statistics of Income". (a) Excluding intercorporate dividends. (b) Over 100 per cent. (c) No percentage computed because of net deficit. (d) Deficit. (p) Preliminary.

remaining 23 years show that, on an average, about 64 per cent of net income was paid out in dividends and 36 per cent was retained for corporate purposes.

A comprehensive analysis as to sources of corporate funds is given in the recent publication of the National Bureau of Economic Research entitled, "The Financing of Large Corporations, 1920-39" by Albert R. Koch. This study showed that, despite the frequently expressed theory that American business, especially as represented by large corporations, has "matured" and can now finance itself through retained earnings and depreciation reserves without having any longer to call upon individual savings, the sales of new securities during the 1930s were actually larger, relative to the level of business activity, than during the 1920s. Such sales were also larger relative to the funds obtained from undistributed earnings, primarily because of the depressed state of earnings during the latter period. It was found that, among major industrial divisions, undistributed earnings were most important as a source of funds to large trade concerns, and least important to railroads, while manufacturing, telephone, and electric power companies fluctuated between these two extremes.

There is no reason to doubt but that after the war, just as before, business will need large amounts of new capital annually in order to meet the deferred demand for peacetime goods plus new products. Financing of this demand will call for all working capital held by the corporations themselves and undoubtedly will require, as in the past, the attracting of new "risk" or "venture" capital through the investment market and also short-term borrowing from the banks. The expected need for bank credit is indicated by the continuing rapid increase in commitments by war material producers for loans, guaranteed in part by the Government under Federal Reserve Regulation V, aggregating up to June 30 over \$4.7 billions, less than a third of which was in use.

In the face of these conditions, one of the best assurances that adequate capital will be forthcoming from all the usual sources is government policies on renegotiation and taxation that will provide reasonable earnings and reserves during the current cycle of abnormally high business volume.

Post-War Shipping Problems

Unless the rapid growth of world shipping is again checked by submarine, surface and air warfare, the world will emerge from the war with a greater ship tonnage than when it began. Even before the recent decline in sinkings, it was anticipated that new building would have made up for war losses by the end of this year.

Distribution of ownership of this tonnage by countries, however, will be radically different from before the war. The United States will have the largest merchant fleet in the world, the result of a shipbuilding program under which we shall have built by the end of 1944 something like 5,000 ships aggregating about 52,000,000 deadweight tons. In nineteen months, from Pearl Harbor to last June, more shipping tonnage was constructed than from 1917 to 1922 inclusive. Barring heavy sinkings, our ocean-going merchant fleet (vessels of 3,000 d.w. tons and over) will approach at the beginning of 1945 some 50 million d.w. tons.

This huge tonnage, if reached, would compare with our pre-war, 1936-39, average of about 13 million d.w. tons, of which, however, only 4 million tons were actually employed in foreign trade services. Of the remaining tonnage roughly 3 million tons were laid-up and 6 million tons engaged in coast-wise trade.

Sometime ago the War Shipping Administrator, Admiral Emory S. Land, estimated that our dry cargo fleet would surpass Britain's by the middle of this year, and by the end of 1943 would be as much as 25 per cent higher. Much of the shipping of the older maritime nations — Great Britain, France, Norway, Denmark, the Netherlands, Sweden and Greece — which among them held about one-half the world shipping tonnage before the war, will be at the bottom of the sea. The share of Great Britain in world ocean-going merchant tonnage, which was nearly 50 per cent in 1913, dropped to about 35 per cent at the time of the outbreak of the Second World War. This percentage has evidently declined still further, though opinions differ how much. Mr. Emanuel Shinwell, Labor Member of the British Parliament, who recently appealed for a strong post-war shipping policy, warned that Great Britain would be left at the end of this war with only about 13 million d.w. tons of merchant shipping, or less than half of its pre-war ocean-going tonnage. On the other hand, according to the London Economist, those who speak of a halving of the British shipping tonnage are "probably erring on the pessimistic side".

Canada and other countries of the British Empire will have larger fleets. Turkey, Ireland, Venezuela, Peru and Colombia will have new merchant marines, and the pre-war fleets of Argentina, Chile, Brazil and Mexico have been considerably enlarged. All these merchant fleets, though relatively small in tonnage, are likely to be strongly championed by their respective governments.

What the position of the Japanese merchant marine will be at the end of the war cannot, of course, be foreseen. Its ocean-going tonnage, estimated at about 7 million d.w. tons, was the third largest in the world when the war broke out. Little information has been publicly avail-

able, but it seems that the losses by sinking have already more than offset the captured Allied tonnage and new construction.

Pre-War and Post-War Tonnage

At the outbreak of the war, total world ocean-going tonnage was about 80 million d.w. tons. Of this tonnage, 13 million tons was owned by the United States, and over 66 millions was foreign-owned, distributed, according to an estimate by the American Bureau of Shipping, as follows:

	(000,000 omitted)
British Empire	24.4
Norway	5.9
Netherlands	3.8
France	3.6
Japan	6.9
Germany	5.1
Italy	4.4
All others	12.2
Total World Tonnage Outside of U. S.....	66.3

This tonnage was, however, considerably in excess of prevailing world trade requirements. Some 4 million d.w. tons of shipping were then idle in the United States, and several million tons were laid up abroad. Moreover, vessels on many routes sailed partly loaded and were able to operate only with the help of government subsidies.

What has already happened or what may happen during the remainder of the war to the 66 million tons of shipping outside of the United States will, of course, not be known until the war is over. If enough replacement of losses is carried out by the end of 1944 to leave as much as 50 million tons outside of this country, together with possibly 50 million tons of the United States, the world will then have some 100 million d.w. tons of shipping, or one-fourth more than before the war.

Replacement of Lost Tonnage

Despite the prospect for an overall glut of ships, it is naturally to be expected that Great Britain, and the other countries whose share in world shipping has declined, will strive to replace their losses. For them shipping has been an important source of national income and foreign exchange, helping to pay for their excess of imports. Also, they feel that their national security is involved. In Great Britain, the press has already come out with proposals such as that "the reconstruction of the fleet will be an essential and urgent post-war task, which must be given a high degree of priority in the re-equipment of British industries." Mr. Pieter A. Kerstens, Netherlands Minister of Economics, Trade and Shipping declared in a recent interview in London that "we cannot imagine a re-arisen Netherlands nor a re-arisen Netherlands East Indies without the Netherlands merchant fleet repaired at least to its old strength. Far from fearing that we may be subjected to some unreasonable restriction in the recovery of our merchant navy we assume we will receive every material and financial assistance we shall or may require for that recovery."

These representations express public opinion and policy in the countries which have seen a great part of their ocean-going fleets sent to the bottom of the sea. They are viewed with sympathetic understanding in this country. Yet new construction programs, to rebuild the lost fleets, will add to the glut of ships that is in prospect, and increase the complexity and magnitude of the world shipping problem.

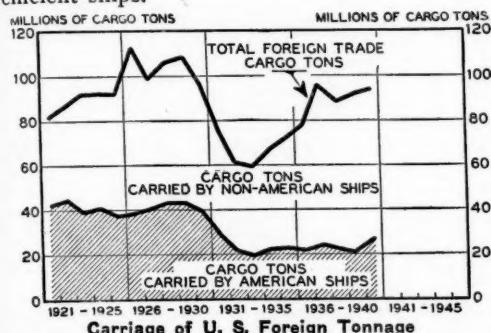
Early in 1942, as was revealed in a recent letter from President Roosevelt to Prime Minister Churchill, the United States and Great Britain reached an understanding that the former would concentrate on mass production of cargo ships and the latter on repair work and naval construction. This was for mutual advantage, and on that ground the view that Great Britain and others of the United Nations should be allowed to acquire American ships on moderate terms is entitled to a hearing. One of the obstacles to a practical program is that each country naturally will want modern and efficient ships, able to hold their own in competition, while probably more than half of our fleet will consist of the relatively slow Liberty ships. Nevertheless, the Liberty ships may fill the immediate post-war need for a general type cargo vessel. A policy with respect to their sale or lease to foreign owners for post-war use remains to be determined.

Meanwhile American ships are being transferred to the United Nations for war-time use, on the basis of the understanding above referred to, and also to utilize manpower more effectively. With 5 to 6 ships being delivered daily, Admiral Land estimated recently that some 7500 seamen and other trained specialists were being needed every month to man the new ships. On the other hand, the Allied Nations have a considerable pool of trained personnel because of their ship losses. President Roosevelt has promised to transfer over a period of about 10 months some 200 vessels of about 2 million d.w. tons to Great Britain for temporary war-time duty. Ships have been transferred also to Norway and Greece, while other Allied Nations, including China, are likewise to benefit from these arrangements.

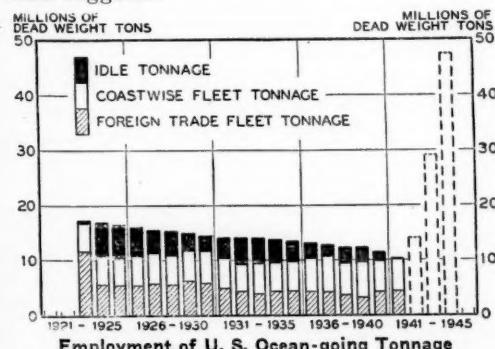
The American Merchant Fleet

The United States is making a huge investment in its merchant fleet, and it is generally agreed that much of it will have to be charged off as a war cost, with idle ships stored as after the last war and shipyards dismantled. But Admiral Land recently called for the establishment of a modern post-war fleet of 15 million to 20 million d.w. tons, privately owned and operated, and to be assured of a liberal percentage of this country's overseas traffic. He would also like to see the expansion of American flag operations to include tramp shipping and services between foreign

countries. Meanwhile steps have been taken, by shifting a part of the construction program from Liberty ships to the newly designed Victory ships, to provide our merchant marine with vessels that will be not only more effective in war service, but better fitted to meet post-war needs. The greater speed of the "Victories", 15 to 17 knots per hour as against 10 to 12 for the "Liberties", makes them not only less vulnerable to submarines, but also more efficient. Naturally shipping circles are reluctant to approve the transfer of these more efficient ships.



An efficient fleet of 15 to 20 million d.w. tons, as called for by Admiral Land, could carry more than 100 million cargo tons of merchandise annually. As will be seen from the chart above, our entire foreign trade cargo tonnage in our best years during the 'twenties was about that size. Obviously every country cannot confine its foreign trade to its own ships, for the exports of one are the imports of another and vice versa. Should our vessels carry after the war one-half of our foreign trade, a great trade expansion would be necessary to keep busy a fleet of the size Admiral Land suggests.



In the days prior to the Second World War, the 4 million d.w. tons or so of our merchant shipping engaged in foreign trade, carried, as the above charts show, about 25 million cargo tons of merchandise, which was roughly about one-fourth of our entire foreign trade tonnage. In contrast about two-thirds of British, French

and German trade was carried in national bottoms, while Japanese ships transported about three-fourths of their country's foreign trade. Probably the percentages will decline in Germany and Japan at least, which will give more leeway for other countries to carry more of their own trade.

Fundamentals of the Problem

Though attempts to solve the surplus shipping problem date as far back as the Boer and the Russo-Japanese war, no really satisfactory way out has ever been found. Shipbuilding has continued to be carried on, and merchant marines are subsidized, for reasons of national security and national prestige. The consideration of having goods carried as cheaply as possible is secondary in many countries.

Possibly some international understanding may be reached on shipping policies. But there are many obstacles in the way of agreements that can cover both the privately-owned highly competitive merchant fleets of Norway and Great Britain, for example, and the state-owned, subsidized fleets of some other countries. As a practical matter, the degree in which the needs of national security, or the advantages of having foreign trade carried most economically, is paramount in shipping policy varies from country to country. To some extent, at least, national policies are fundamentally irreconcilable with international concord on shipping questions.

The most constructive way of solving the problem of the post-war shipping surplus would be, of course, through larger international trade. The opportunities are great and are limited only by the scope of human ingenuity and enterprise and the extent to which governments encourage or discourage these qualities and pursue trade policies that encourage or discourage international commerce. Those nations which aspire to have a large merchant marine have an interest in policies looking towards a broadening of trade between nations.

Another major need is to encourage private enterprise in the shipping business. During the reconstruction period immediately following the war, at least, the ocean-borne movement of goods is likely to be on an enormous scale, requiring larger ship tonnages than before the war. Conditions then will be more favorable than later for transferring government owned vessels to private ownership. The United States will have a great deal to gain, through avoiding the mistakes after World War I, if it will take the opportunity to establish shipping on a sound basis. The dominant need is that the Government establish a policy with respect to its war-built tonnage at the earliest possible moment, for until the Government plans, private enterprise cannot plan.

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